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ABSTRACT

This lesson on choosing the type of ownership, the fifth in a series of 18 units, is part of the first level of a comprehensive entrepreneurship curriculum entitled: A Program for Acquiring Competence in Entrepreneurship (PACE). (Designed for use with secondary students, the first level of PACE introduces students to the concepts involved in entrepreneurship and helps them become aware of entrepreneurship as a career option.) The following topics are covered in the unit: sole proprietorships, partnerships, corporations, and franchises; local examples of each type of business ownership; and the advantages and disadvantages of each type of ownership. Included in the lesson are instructional text organized in a question-and-answer format, individual and group learning activities, and assessment questions. (MN)

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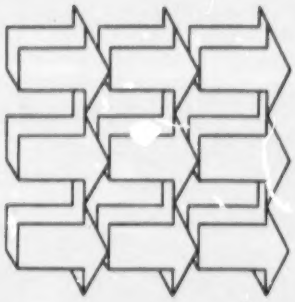

UNIT 5

- [x] Level 1
- [ ] Level 2
- [ ] Level 3

Choosing the Type of Ownership

Developed by M. Catherine Ashmore and Sandra G. Pritz

You will be able to:

- **Describe sole proprietorships, partnerships, corporations, cooperatives, and franchises.**
- **Identify examples from your own community of each of the types of business ownership.**
- **Describe the advantages and disadvantages of proprietorships, partnerships, corporations, franchises, and cooperatives.**

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BEFORE YOU BEGIN. . .

1. Consult the *Resource Guide* for instructions if this is your first PACE unit.

2. Read the Unit Objectives on the front cover. If you think you can meet these objectives now, consult your instructor.

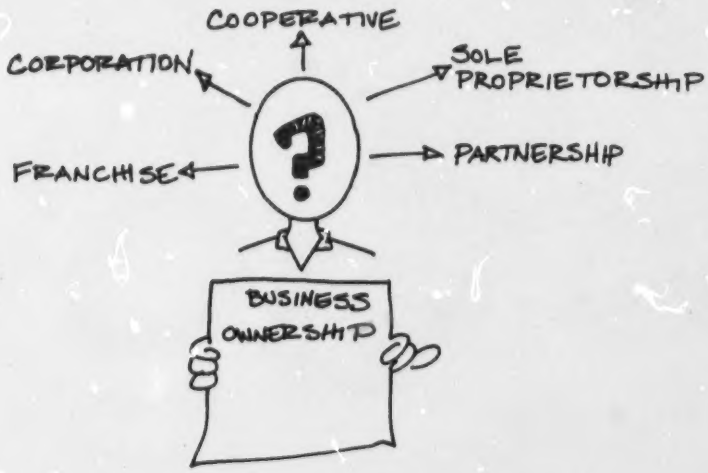
3. Look for these business terms as you read this unit. If you need help with their meanings, turn to the Glossary in the *Resource Guide*.

   economic base
   indirect competition

CHOOSING THE TYPE OF OWNERSHIP

WHAT IS THIS UNIT ABOUT?

When you are planning to start your business, you have to decide which type of ownership would be best for your firm. This unit will focus on the three major types of business ownership: sole proprietorships, partnerships, and corporations. Information on franchises and cooperatives is also included. The basic steps necessary to establish each form of business will be discussed.



The main purpose of this unit is to discover what form of business ownership or organization is "right" for you. This often depends on your background and resources. The unit also tells about the characteristics, advantages, and disadvantages of each form of business organization.

WHAT ARE THE VARIOUS TYPES OF OWNERSHIP?

A large corporation may not need the same form of business organization as a small drugstore, a health food shop, a nursing home, or a restaurant. To find the best organization for your business, you will need to understand various types of ownership. These are—

- sole proprietorships,
- partnerships,
- corporations,
- franchises,
- cooperatives.

WHAT IS A SOLE PROPRIETORSHIP?

The most common form of business organization is the sole proprietorship. Sometimes it is also called the individual proprietorship. This business is owned by one person. It is usually operated by this person. Many times it is run with the help of a few employees, often family members. Sole proprietorships can usually operate with very limited capital resources (money). Sole proprietorships exist in a great variety of businesses. These may include the neighborhood beauty parlor, bike repair shop, restaurant, newsstand, or accounting office.

The sole proprietorship is the least complicated form of organization. It is the easiest to enter into and to terminate. Entry requires little more than a location, expertise in the area of business considered, a source of capital, the ability to make contracts, and the desire to start your own business. Termination generally requires paying your debts and closing your doors.

WHAT IS A PARTNERSHIP?

Next to the sole proprietorship, the partnership is the least complicated way to begin and operate a business. A partnership is a business that has two or more (usually not more than five) co-owners. Often, but not always, a partnership is formed when a sole proprietor takes on additional owners. These additional owners help in certain areas of expertise or skill. They may aid in expanding the business by raising additional capital—there is a limit to what one person can borrow. Partnerships are found in every type of business. This includes law and medical firms. Forming a partnership may be the answer for many businesses, especially those that require more initial capital than one person can raise alone.

Several types of arrangements can be made with a potential partner. For example, not all partners want to have equal ownership and responsibility. They may desire to be limited partners. Most limited partners invest in a business. They do not have a voice in management.

WHAT IS A CORPORATION?

Another type of ownership is the corporation. Sole proprietorships outnumber corporations in the total number of U.S. businesses. But in the number of dollars earned and people employed, the corporation is the largest form of business organization in the United States today. The corporation is chartered by a state and is characterized by three or more owners. It is given the power to transact business, to enter into contracts, and to sue or be sued as a legal entity. The corporation acts on its own through its officers. They have power to make contracts and carry out business activities. These are done in the same manner as a sole proprietorship or partnership. Thus, a corporation is an entity created through state laws for the purpose of doing business.

The owners of a corporation are the stockholders. The number of stock certificates they purchase determines the extent of their ownership. After the corporation has been chartered, the stockholders must elect a board of directors. The board of directors appoints the officers or managers of the business.

Forming a corporation offers advantages to those who need lots of capital. But it requires a large amount of extra capital to start and to operate. The corporation is not suitable for all businesses. However, it is an important part of the American economic system.

WHAT ARE COOPERATIVES?

A cooperative is an organization of individuals with similar interests and problems who have joined together to perform certain activities. Although cooperatives are not a legal form of ownership, they do represent a business structure owned and directed by its own customers (members). The formal ownership structure for most cooperatives is similar to that of a corporation. A cooperative is financed by selling shares to its members, to whom it distributes its profits (dividends). The rate of distribution of profits and even the system for sharing profits among all members varies greatly from one co-op to another.

Most cooperatives form to serve the needs of a group better. Since a group acting collectively can sometimes serve its members' needs more economically than individuals acting alone, cooperatives are more important in some fields than in others. For example, farming cooperatives are important organizations.

There are many different forms of cooperatives. Some of the more common cooperatives are as follows:

- Food co-ops
- Gasoline co-ops
- Housing co-ops
- Credit unions
- Mutual insurance associations
- Mutual savings and loan societies
- Group health co-ops
- Nursery (day-care center) co-ops
- Electric power co-ops
- Travel co-ops
- Bakery co-ops

These cooperatives are organizations for selling, buying, or service (or a combination). Many well-known companies are never thought of as being cooperatives. FTD (Florists' Transworld Delivery), IGA (Independent Grocery Association), Consumer's Union, United Parcel Service, Nationwide Insurance, and Ohio Wool Growers' Cooperative Associations are all cooperatives.

WHAT IS A FRANCHISE?

A franchise is basically a contract to distribute and sell a parent company's goods or services in a specified geographic area. The franchise is sold by a parent company. This is the franchisor. The franchise is sold to an individual. This is the franchisee. The contract establishes a continuing association between the two. The franchisee is guaranteed the right to use the parent company's name and product. In turn, the franchisee pays a certain percentage of the profits to the franchisor. Specific procedures vary from company to company. However, the franchise is based on a contract listing the rights of and restrictions on both parties.

WHAT ARE THE ADVANTAGES OF A SOLE PROPRIETORSHIP?

Certain advantages of the sole proprietorship are rather obvious. You have often heard people say, "If I ran this operation . . . ." or "I'd like to be my own boss." That is exactly what the sole proprietor is—the boss! As the boss, you have freedom of action and operation. As long as you don't break the law or violate the rights of others, you can run

the business in any manner you choose. You are free to make your own mistakes and to enjoy your own successes. You can seek the advice of others, but you make the decisions.

Other advantages of the sole proprietorship are—

- greater freedom from government regulations,
- a tax advantage to the small owner,
- accrual of all the profits to the owner,
- limited cost of actually starting the business (you pay no legal fees to get started).

WHAT ARE THE DISADVANTAGES OF A SOLE PROPRIETORSHIP?

The main disadvantage of being a sole proprietor is that you have unlimited liability. All business ventures entail risks. But in the sole proprietorship, no one else shares the risk. The creditors of a sole proprietor can force the business to close if debts remain unpaid. Even worse, the creditors can also claim your personal property (unlimited liability) if the sale of the business assets does not pay your debts. Thus, business failure can lead to the loss of your home, car, and other possessions, as well as your business.

Other disadvantages of the sole proprietorship include—

- the difficulty of raising capital,
- the lack of assistance in operating the business—you as an owner need expertise in many areas,
- the limited life of the business. If the owner gets sick or dies, the business must temporarily close down or possibly end for good.

ARE THERE ADVANTAGES OF A PARTNERSHIP?

One advantage of a partnership is a variety of skills, abilities, and ideas. These are brought to the agreement by each partner. Each partner does not need to be an expert in all areas of the business. Each can concentrate on his or her area of expertise. Having partners also means that if one owner is ill or on vacation, the business can continue to operate. Other advantages of a partnership are—

- more sources of capital (two can borrow more often—even if not more cheaply—than one),
- easy entry and termination of business,
- low start-up costs that are similar to those of a sole proprietorship, but with the additional cost of contract preparation,
- possible tax advantages,
- limited outside regulations.

WHAT ARE THE DISADVANTAGES OF A PARTNERSHIP?

The main disadvantage of a partnership is that, like a sole proprietorship, the partners have unlimited liability. Therefore, the owners' personal property can be seized to settle business debts. An added disadvantage of a partnership is that one partner may not give as much time and effort as the other, yet still get an equal share of the profits. Two heads are better than one only if both heads are working.

Other disadvantages of a partnership are—

- having to share profits,
- possible limited life of the organization,
- difficulty in raising additional capital,
- the difficulty in finding suitable partners—those with the needed skills may be incompatible, untrustworthy, or unwilling to share the responsibilities.

WHAT ARE THE ADVANTAGES OF CORPORATIONS?

There are many advantages to the corporate form of business organization. This is especially so if a large capital outlay is needed for machines, fixtures, or inventory at the outset. The corporation has limited liability. This means that only the assets of the corporation, not those of the individual owners, can be used to pay creditors. If a person owns stock in a corporation and the corporation is unable to pay its creditors, that stock may become valueless. But the owner will not lose more than the value of his or her own stock. Only business assets may be used to pay corporate debts.

The corporation also finds it easier to raise money and obtain credit, because a corporation usually has many owners, and thus has a solid block of capital. This makes it easier to get credit. The corporate board can agree to issue new stock and sell it to the public when additional capital is needed. The selling of new stock, however, can be done only if the owners want stock issued.

Some other advantages of the corporation are—

- a great variety of skills, abilities, and ideas are available;
- the responsibilities of ownership can be transferred simply by selling your stock,
- the corporation can continue to exist despite changes in owners.

WHAT ARE THE DISADVANTAGES OF CORPORATIONS?

The corporation also has disadvantages. It is more complicated and expensive to organize and run than the sole proprietorship and the partnership. It involves obtaining a charter. It involves having a Certificate of Incorporation drawn up by a lawyer. The corporation can perform only those activities stated in its charter. It may not engage in out-of-state business activities without paying a special fee. The corporation must file reports regularly with the government. This may require the services of specialized and expensive employees.

Other disadvantages of the corporation include—

- the sharing of profits,
- double taxation—the profits of a corporation are taxed as corporate income, and as the stockholder's income,
- a higher rate of taxation than any other form of business organization. (However, if you form a Subchapter 5 Corporation, which is ideal for new and low income businesses, your corporation may be taxed at individual rates.)

WHAT ARE THE ADVANTAGES OF FRANCHISES?

Franchising offers distinct advantages to you if you want to own your own business but lack the expertise and facilities to do so. The franchisor normally provides many things; things that you, as a sole proprietor, would have to provide yourself. You would receive technical advice on design and layout of facilities, market research findings, and help in advertising, buying, and inventory.

Other advantages of franchising include—

- smaller than usual capital investment,
- less working capital necessary,
- a product or service that usually has prior public acceptance,
- better-than-average profit margins.

WHAT ARE THE DISADVANTAGES OF FRANCHISES?

Franchises do have disadvantages for the franchisee. You must do things according to the rules of the parent company. Depending on the company, this may restrict your freedom of action. You must maintain certain standards of service. You can sell only the parent company's product or service. Commonly, the franchise agreement requires the franchisee to pay a percentage of the profits back to the parent company. Cancelling the contract may sometimes prove difficult.

ARE THERE EXAMPLES IN YOUR OWN COMMUNITY OF EACH TYPE OF BUSINESS OWNERSHIP?

When you watch TV or drive through your community, you are exposed to various types of business ownership. Sole proprietorships, partnerships, corporations, franchises, and cooperatives can probably be seen in your community. These types of ownerships may be seen in such businesses as a fast food operation, a small drug store, a real estate agency, a neighborhood grocer, or a florist. Are you able to identify these various types of business ownership in your community? Review the advantages and disadvantages of these forms of ownership. Use the table on the next page.

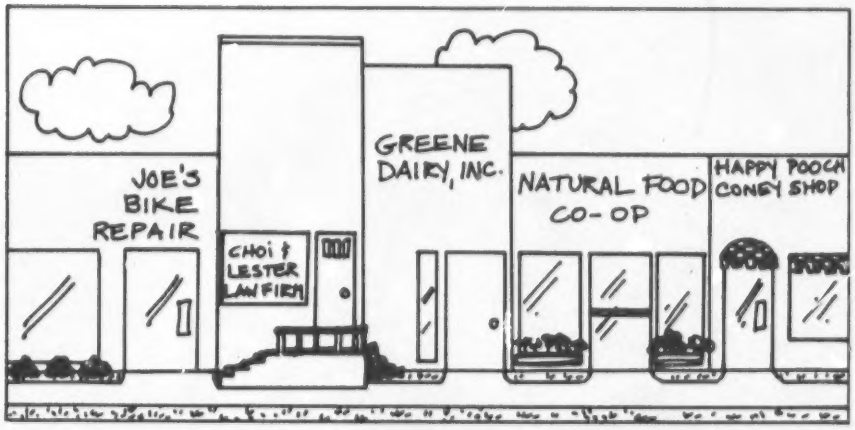


TABLE 1

ADVANTAGES/DISADVANTAGES OF TYPES OF OWNERSHIP

FORMS OF OWNERSHIP	ADVANTAGES	DISADVANTAGES
Sole Proprietorship	1. Low start-up costs 2. Greatest freedom from regulation 3. Owner in direct control 4. Minimal working capital requirements 5. Tax advantage to small owner 6. All profits to owner	1. Unlimited liability 2. Lack of continuity 3. Difficulty in raising capital
Partnership	1. Ease of formation 2. Low start-up costs 3. Additional sources of venture capital 4. Broader management base 5. Possible tax advantage	1. Unlimited liability 2. Lack of continuity 3. Divided authority 4. Difficulty in raising additional capital 5. Difficulty in finding suitable partners
Corporation	1. Limited liability 2. Specialized management 3. Transferable ownership 4. Continuous existence 5. Legal entity 6. Possible tax advantages 7. Ease of raising capital	1. Close regulation 2. Most expensive form to organize 3. Charter restrictions 4. Extensive recordkeeping 5. Double taxation
Franchise	1. Smaller-than-usual capital investment 2. Less working capital than normally required 3. Prior public acceptance of product or service 4. Management assistance 5. Better-than-average profit margins	1. Possible high franchisor fees, supplies, and charges 2. Some loss of independence 3. Possible difficulties in cancelling contracts

SOURCE: Adapted from Kuebbeler, Gary L. *Going into Business for Yourself.* Columbus: Ohio Distributive Education Materials Lab, The Ohio State University, n.d.

ACTIVITIES

The following activities are designed to help you develop insights, opinions, questions, answers, and attitudes.

Do you feel knowledgeable about the various types of business ownerships? Are you able to identify advantages and disadvantages of each type of ownership? The following activities will help you assess your knowledge.

INDIVIDUAL ACTIVITY

Ask your instructor for a copy of the crossword puzzle on the types of ownership to determine if you know the terms associated with various types of ownership.

GROUP ACTIVITY

In your community you can find various types of business ownership. Get together in small groups, three or four persons per group, and prepare a form like the one below. In the left-hand column list these types of business:

- Family-owned restaurant
- Beauty parlor
- Book store
- Record shop
- Real estate office
- Hardware store
- Fast food store
- Nursing home
- Florist
- Carpet manufacturer
- Gasoline station
- Electrical power company
- Bakery
- Auto repair shop
- Department store

List in the right-hand column, if possible, examples of each type of ownership (sole proprietorship, partnership, corporation, franchise, and cooperative) in your community.

Type of Business	Examples of Types of Ownership
a. Family-owned restaurant	
b. Beauty parlor	
c. Book store	
d. Record shop	

CASE STUDY

Bill Smith has been involved in the restaurant business for several years. He has been a dedicated employee and has received a great deal of valuable training. However, he has always wanted to go into business for himself.

After examining several different possibilities, Bill has decided he would like to invest in a fast food franchise. The franchise he would like to invest in has proven to be successful for previous investors. Bill feels that he has the knowledge to operate the franchise.

Bill contacted the franchisor and learned that the franchise fee was $25,000 plus 5 percent of the company's gross revenue. This amount of money would require Bill to use all of his savings, plus borrow $10,000. The franchisor is able to offer his services to help in operating the franchise. Bill has spoken to his banker and the additional money he needs to borrow is available. Now Bill must make a decision.

1. What are the advantages and disadvantages associated with buying a franchise?

2. What would be your recommendations for Bill? Explain your recommendations.

ASSESSMENT

Directions: Read the following assessment questions to check your own knowledge of the information in this unit. When you feel prepared, ask your instructor to test your competency on them.

1. Identify the five types of ownership discussed in this unit.

2. Identify at least two advantages and disadvantages of each type of ownership (excluding cooperatives) discussed in this unit.

NOTES

[1]Kuebbeler, G. L. *Going into Business for Yourself.* Columbus,: Ohio Distributive Education Materials Lab, n.d., pp. 17-38.

We thank the above author for permission to reprint from his work.

OTHER SOURCES USED TO DEVELOP THIS UNIT

Hodgetts, R. M. *Effective Small Business Management.* New York: Academic Press, 1982.

State Department of Vocational and Technical Education. *Distributive Education II: A Course of Study.* Curriculum Guide. Stillwater, OK: State Department of Vocational and Technical Education, 1972.

For further information, consult the lists of additional sources in the *Resource Guide.*

PACE

Unit 1. Understanding the Nature of Small Business

Unit 2. Determining Your Potential as an Entrepreneur

Unit 3. Developing the Business Plan

Unit 4. Obtaining Technical Assistance

Unit 5. Choosing the Type of Ownership

Unit 6. Planning the Marketing Strategy

Unit 7. Locating the Business

Unit 8. Financing the Business

Unit 9. Dealing with Legal Issues

Unit 10. Complying with Government Regulations

Unit 11. Managing the Business

Unit 12. Managing Human Resources

Unit 13. Promoting the Business

Unit 14. Managing Sales Efforts

Unit 15. Keeping the Business Records

Unit 16. Managing the Finances

Unit 17. Managing Customer Credit and Collections

Unit 18. Protecting the Business

Resource Guide

Instructors' Guide

Units on the above entrepreneurship topics are available at the following three levels:

- Level 1 helps you understand the creation and operation of a business
- Level 2 prepares you to plan for a business in your future
- Level 3 guides you in starting and managing your own business

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